

---

**JOINT COMMITTEE REPORT ON**

**RISKS AND VULNERABILITIES IN THE EU FINANCIAL SYSTEM**

AUTUMN 2025

<b>Executive Summary and Policy Actions .....</b>	<b>2</b>
<b>1 Overview of Risks in the Financial System.....</b>	<b>3</b>
<b>2 Cross sectoral deep dive on impacts of geopolitical risk and fragmentation .....</b>	<b>7</b>
2.1 Impact of US Tariff Changes.....	7
2.2 Impact of Increased Spending Including Defence .....	15
2.3 Conclusions .....	16

## EXECUTIVE SUMMARY AND POLICY ACTIONS

**Global trade and security developments have led to sudden structural changes and contributed to a deteriorating economic outlook.** On trade, the US announced a series of sizeable and widespread tariffs, indicating protectionist intent and marking a step towards a more fragmented global economy. The scale and frequency of US trade policy announcements and the international responses to them added to already elevated geopolitical uncertainty from ongoing wars and conflicts. In June there were concerns that the Israeli-Iran and Israeli-Hamas conflict in the Middle East could reignite and have impact on the financial sector. Until end of August, developments around the Russian war against Ukraine – including the latest diplomatic efforts, whose outcome and next steps seem to be open – and around the conflict in the Middle East remain unpredictable.

**With these geopolitical developments, growth forecasts were revised downwards, with signs of divergence between EU and US monetary policy.** In April, the IMF lowered its global growth estimates to 2.8% for 2025 and 3% for 2026, both down from the 3.3% January estimates. US growth in 2025 was lowered to 1.8%, 0.9 ppt down, and EA growth was lowered from 1% to 0.8%. In May, the European Commission revised its growth forecasts down for the EU, to 1.1% for 2025, down 0.4ppt, and to 1.5% for 2026, down 0.3ppt.<sup>1</sup> The reduction in growth was associated mostly with the ongoing uncertainty and to a lesser extent with the economic impact of tariffs. More severe tariffs or further retaliation would worsen the outlook. The ECB cut interest rates by 25bps in April and June, while the Federal Reserve kept rates unchanged amid inflation concerns associated with the new tariffs. According to the latest available projection as of end of August, as clarity on the tariffs grew, the IMF presented upward revisions to its global growth estimates to 3.0% for 2025 and 3.1% for 2026<sup>2</sup> US growth estimates for 2025 have been revised upwards to 1.9% as well as EA estimates increased back to 1%, in line with January IMF projections.

Against this background, the Joint Committee advises the European Supervisory Authorities (ESAs), national competent authorities, financial institutions, and market participants to take the following policy actions:

- **Geopolitical risks are cross cutting and impact various aspects of financial institutions' operations, and risk exposures.** Currently, it is particularly important for financial institutions to continue to incorporate risk considerations stemming from geopolitical developments into day-to-day business processes and risk assessments. In the current geopolitical context, the continued access to market infrastructures, including from service providers domiciled outside the EU, remains central to preventing potential market disruptions and maintaining investor confidence.
- **With ongoing deep geopolitical uncertainties and rapidly changing global trade policies, financial institutions need to plan for different scenarios.** They should have proper risk management capacities in place to address unexpected short-term and medium-term multi-fold challenges, particularly sudden changes that can materialise through many channels, such as market corrections. This includes adequate provisioning levels and forward-looking provisioning policies. Stress testing and scenario analysis are powerful tools to support such risk assessments, and to test resilience and liquidity positions.
- **Financial institutions and supervisors should remain vigilant to operational and financial stability risks that could arise from cyber-risks.** Cyberattacks continue, including successful ones, and the sophistication of attacks is growing. In addition, high levels of concentration in the use of third-party IT providers and dependencies on them can further increase cyber risk and exacerbate contagion as well as the potential systemic impact of cyber incidents. Entities operating in the financial sector and their supervisors should address cyber risks more holistically, and swiftly and thoroughly implement the framework that DORA provides about risk management, incident reporting, threat-led penetration testing and supervisory cooperation. They should include providing sufficient resources to address cyber-risks. Entities and supervisors should also be prepared to address challenges brought by the rapid evolution of technologies, such as artificial intelligence, while also acting on the opportunities they offer.
- **While contagion risks from crypto assets remain limited, these should be monitored as these markets expand, and interlinkages grow between crypto markets and the traditional financial sector.** Close relationships and new business lines have been developing between traditional market players and digital asset markets. Some banks have further progressed their engagement with digital assets, including direct exposures. This presents opportunities to provide clients with access to the digital assets market, but it also entails risks.
- **Financial institutions can play a significant role in supporting plans for the Savings and Investments Union (SIU) as announced by EU legislators.** Further steps towards the finalisation of the Banking Union will be important as well. These are not least relevant in light of the EU Commission's strategy of competitiveness, burden reduction and simplification. Given the ambition to connect savings to most productive investments, a sound supervisory system will be important to build the necessary trust with consumers in the market. Also, the structural shift toward alternative investments observed in the UK and US—now gradually emerging in the EU—underscores the growing importance of understanding the expanding NBFi sector. The intrinsically lower liquidity and credit risk of alternative investments compared to traditional investments should be monitored to safeguard financial stability.

<sup>1</sup> EC Spring 2025 forecasts

<sup>2</sup> IMF July 2025 WEO

## 1 OVERVIEW OF RISKS IN THE FINANCIAL SYSTEM

**Geopolitical developments in first half of 2025 drove financial market corrections.** Ukraine was still under attacks from Russia that continues its war of aggression and financial markets remained volatile. Shifts in global trade and defence are creating new challenges. The German announcement to increase defence spending led to a surge in euro-area bond yields in early March. Global equity markets then fell in early April due to US tariff announcements, causing heightened volatility. Notably, USD and US treasury yields rose, while German Bunds and the Euro appreciated, suggesting a shift from US treasuries to Bunds. The US tariff announcements drove sharp increases in corporate bond spreads in the EU and the US with a larger increase in high-yield spreads, reflecting a sharp tightening of credit conditions in bond markets, increased risk-aversion, and a flight-to-safety. In late April, equity and currency markets recovered on more positive news on the US-China trade war. Following the outbreak of the Israeli-Iran conflict on June 13, oil and natural gas prices rose significantly on concerns that supply and distribution could be affected.<sup>3</sup> After the June sharp market reaction, prices reversed and did not move with the same breath as of end August.

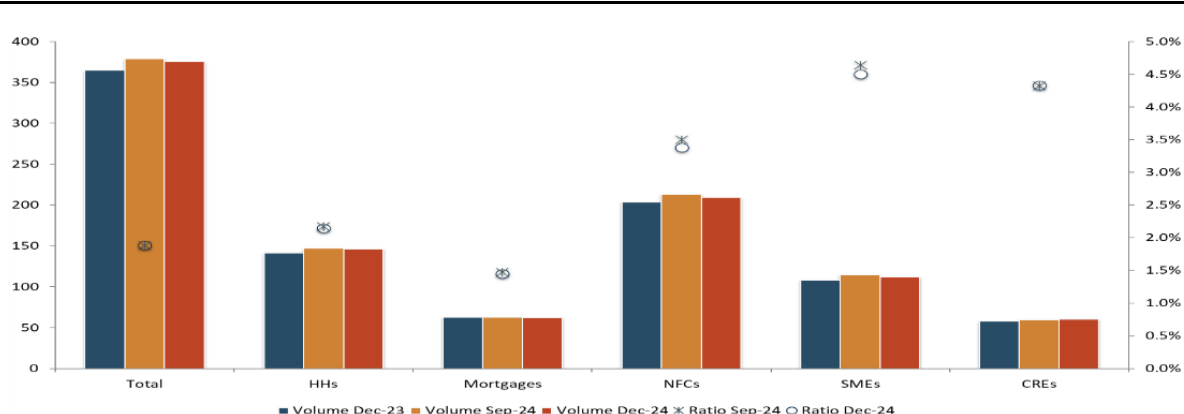
**The EU banking sector has so far demonstrated its resilience against a worsening economic outlook and rising geopolitical tensions.** In 2024, profitability remained high with a return on equity (RoE) of 10.5% at year-end, down from 10.9% in June 2024. Increases in net trading income and net fee and commission income supported returns for banks, while net interest income broadly held steady supported by lending growth. Capital ratios remained high, with a CET1 ratio of 16.0% at year-end 2024, compared to 16.1% in June 2024.

**Banks to date appear to have adequately managed asset quality amid a deteriorating economic outlook.** The ratio of non-performing loans (NPLs) remained low at 1.9% in Q4 2024, unchanged from Q3 2024, but slightly increased compared to a ratio of 1.8% in Q4 2023. The volume of NPLs declined by 1% to EUR 379bn in Q4 2024, but increased compared to year-end 2023. All loan segments reported reductions in NPLs, except for commercial real estate (CRE). Loans under IFRS 9 Stage 2 classification rose by 2% to EUR 1.5tn, accounting for 9.7% of the total loan portfolio, being a sign of asset quality deterioration. Indications from Q1 2025 results suggest that EU/EEA banks have held up resilient and with no major impact from geopolitical developments. Profitability has remained broadly stable in a year-on-year comparison, and there have not been any signs of a significant deterioration in asset quality. However, an observed uptick in cost of risk might signal that banks have started to increase their provisioning amid the geopolitical situation.

**The uncertain economic environment has not yet materially weighed on bank risk appetite** by end 2024, and bank assets have grown quicker than in previous years. EU/EEA bank assets grew 3.2% to EUR 28.2 tn in 2024, primarily driven by an increase of ca. EUR 580bn (+3.4%) in outstanding loans and advances, which totalled EUR 17.7tn in December 2024. Banks also reported notable increases in debt securities held (+10.8%) and in equity holdings (+37.0%). Total loans to households increased 2.2%, mainly due to mortgage lending, while lending to non-financial corporates (NFC) rose 1.4%. Lending surveys suggest that banks have maintained strict lending standards, particularly for corporate lending, slowing corporate loan growth. Demand for corporate lending has remained sluggish not least reflecting the ongoing economic weakness, and slightly decreased in Q1 2025. At sectoral levels, EU/EEA banks increased loans towards electricity and gas supply activities (+6.5% YoY) and loans towards financial and insurance sectors, which had the second largest volume increase.

---

<sup>3</sup> From June 12 to June 19, the Brent oil price rose 11%, while the Dutch TTF gas prices rose 14%.

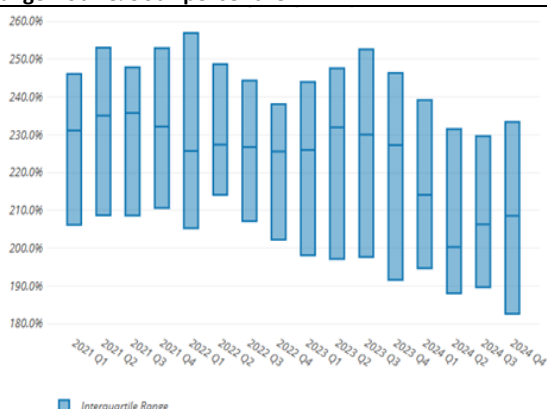
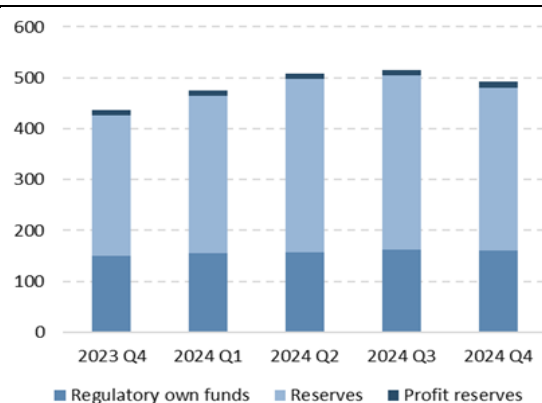
**Fig 1: EU banks non-performing loan volumes and ratios, by segment, Q4 2023, Q3 2024 and Q4 2024**

Source: EBA supervisory reporting data

**The European insurance sector also demonstrated resilience overall, as of end 2024.** After a period of stagnation, life premiums are growing again, and technical cash flows improved from previous year. With interest rates stabilising, lapse rates may have peaked. The unit-linked business has also recovered, reversing its decline since 2022. Profitability has improved, driven by strong investment returns. The industry, due to its adequate capitalization, is well equipped to withstand market turmoil that materialised in the second quarter of 2025. The 2024 insurance stress test exercise, which focused on the economic consequences of a re-intensification or prolongation of geopolitical tensions serves as a reference for the movements recently observed. The results, while showing the sensitivity of the insurance industry to the scenario, confirmed its resilience due to the adequate level of capitalization on the basis of the current Solvency II framework.

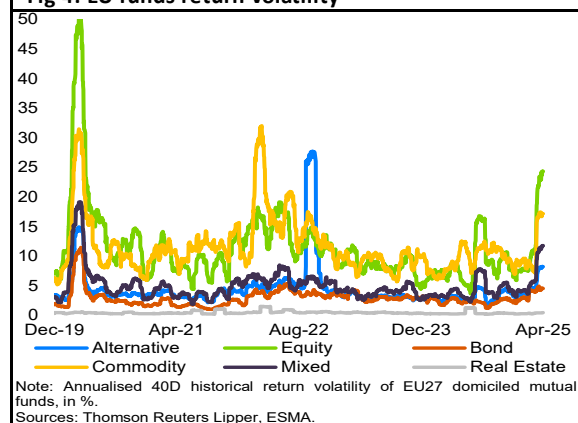
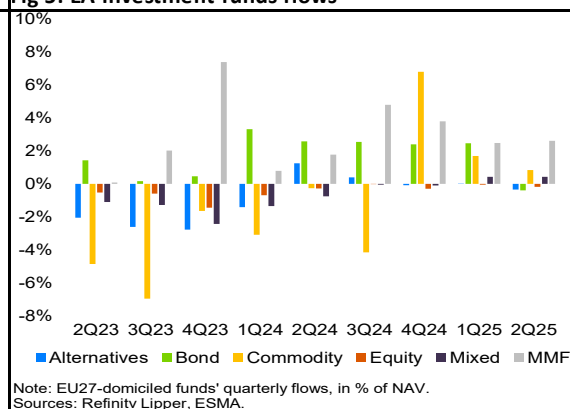
**The EEA European sector for occupational pensions stayed resilient through the dynamic interest rate environment.** The financial position of IORPs in the EEA improved slightly, driven by asset growth outpacing liability growth. Asset values increased due to equities and bonds revaluations, while liabilities grew because of several reasons, e.g.: liabilities' indexation to inflation, interest-rate developments, variation in volumes<sup>4</sup> and regulatory changes in some Member States. This resulted in different effects on defined benefit (DB) and defined contribution (DC) schemes. The asset allocation of IORPs remained stable. However, the ongoing transition from DB to DC schemes represents a major operational challenge for the sector and might reshape investment strategies and exposure to equity market volatility, and longevity risks, particularly affecting women. A robust three-pillar pension system can help mitigate these risks, reduce pension gaps, and support the Savings and Investment Union by increasing investment through pension savings. The recent market turmoil in April also warrants close monitoring of IORP funding ratios and liquidity positions. The latter is currently being tested in the 2025 IORP stress test exercise which targets the liquidity resilience of the IORP sector in two scenarios: 1) the case of a sharp increase interest rates due to the abrupt escalation of geopolitical tensions and 2) the case of a swift decline in interest rates as market participants internalise an unexpected prolongation of geopolitical tensions, triggering a loss of confidence in financial markets.

<sup>4</sup> Detailed statistics for IORPs Members will be available with the 2024 Annual Reporting.

**Fig 2: Solvency Ratio for groups, median, interquartile range 10th & 90th percentile****Fig 3: Regulatory own funds and reserves**

**The investment fund sector also remained resilient despite the volatile environment in H1 2025.** EU fund returns experienced high volatility. For alternative and commodity funds this was their highest episode of volatility since the Ukraine invasion, while for equity, mixed and bond funds it was highest episode since the COVID-19 outbreak. Equity funds returns were particularly volatile (23% 40-day return volatility) due to their exposure to the US equity markets, which represent nearly half of their holdings. Commodity and mixed funds also experienced substantial jumps in volatility.

**Investment fund markets experienced subdued and uneven flows in H1 2025.** Equity funds saw modest net outflows, particularly compared to previous years, but experienced higher volatility during the market turmoil in early April, though this pattern was not uniform across Member States. Bond funds experienced net outflows in Q2, reversing earlier gains. Mixed funds attracted small inflows, and MMFs continued to see inflows<sup>5</sup>, though less pronounced than in late 2023. Overall, asset reallocation appears limited so far in 2025. Many hedge funds that had basis or swap spread trades were caught by the April volatility and needed to unwind positions and so to sell US Treasury bonds to meet margin calls. Despite the size of the Treasury basis trade<sup>6</sup>, the unwinding process remained broadly orderly, likely because many funds had already scaled back their stock and bond positions and had reduced leverage in the weeks prior to the tariff announcement. As equity market valuations have since recovered from the early April market turbulences, the again high valuations of the equity market, especially in the US, pose risks of sudden repricing.

**Fig 4: EU funds return volatility****Fig 5: EA investment funds flows**

<sup>5</sup> Flows to MMFs—particularly French MMFs—may follow a cyclical pattern, with structural outflows likely related to end-of-quarter cash flow management by institutional investors.

<sup>6</sup> According to the Office of Financial Research (OFR), hedge funds were net short USD 1.1tn of Treasury futures in mid-March, with estimates of the aggregated size of the basis trade generally standing at around USD 800bn.

Despite the high volatility, the extensive margin calls in the period of turbulence in April did not create problems for cleared products in central clearing counterparties (CCP) based in Europe or in those CCPs outside the EU but supervised by ESMA (Tier 1 and Tier 2<sup>7</sup>). In its most recent CCP stress test, ESMA found that CCPs have robust lines of defence to withstand significant market shocks and are resilient to substantial liquidity stress events, though some gaps persist in the coverage of concentration risk across CCPs and across asset classes, notably for commodity derivatives.

Sudden unexpected developments in the geopolitical area, or in the ongoing global trade disputes, could lead to further rapid adjustments in economic outlook and risk appetite, which could drive further market corrections and volatility. Geopolitical uncertainty also remains high generally including, e.g., from the continuing Russian invasion of Ukraine and the war in the Middle East. In this context, the continued stability of market infrastructures remains central (BOX 1).

#### BOX 1 – Dependencies on US and other non-EU infrastructures and service providers

**In the current geopolitical context, the continued stability of and access to market infrastructures remains central to preventing potential market disruptions and maintaining investor confidence.** The sudden policy shifts on global trade and resulting market developments is highlighting the importance of inter-dependencies in the global financial system. The importance of US financial markets and market infrastructure render the EU financial sector vulnerable to risks and volatility originating from outside the EU.

**Also, many key third party service providers of EU financial institutions are domiciled outside the EU.** Information technology providers are particularly salient examples. The Draghi report<sup>8</sup> illustrates how information technology services have become increasingly dominated by US firms. From 2013 to 2023, the EU's share of global revenues in information technology fell from 22% to 18%, while the US share rose from 30% to 38%, and China's from 10% to 11%. Cloud-service providers are a specific case, where three largest firms are US-based and hold 63% of the global market share.<sup>9</sup> Such dependencies strengthen arguments for greater EU autonomy in financial markets.

**EU market infrastructures have important dependencies on the US, and EU firms have important dependencies on US- or US-owned infrastructures.** For example, US entities have an important stake in EU-registered trading venues, owning 14% of these by number, while 11% of benchmarks are administered by US entities. There is significant listing in the US by EU firms, with over 100 EU companies solo listed in the US and over 650 dual-listed in US and EU. In derivative clearing, 98% of the clearing of products denominated in EU currencies that is carried out by Tier 1 CCPs is done by two US-owned CCPs.

**In the banking sector, 60% of EU banks indicated to have received clearing and settlement services from non-EU operators.** EU banks have significant exposures to two systemically important UK-based CCPs and to an US-based CCP.<sup>10</sup> Data does not suggest dependencies from CCPs located in any other non-EU jurisdictions. Exposures to the three major non-EU CCPs represent 21% of the total derivatives notional and 2.0% of the total derivatives exposure value in the EU, of which 19.9% and 1.4%, respectively, are exposures to the two UK-based CCPs.<sup>11</sup> The share of individual banks' exposures to the three major non-EU CCPs differs significantly, and some EU clearing members are exposed significantly.

**EU insurers have a relatively low exposure to US-based Central Counterparties (CCPs).** Only 0.1% of their centrally cleared derivatives are cleared through US CCPs as of Q4-2024. This represents a small fraction of their overall centrally cleared derivative trades, which account for approximately 22% of their total derivative

<sup>7</sup> Tier 1 are TC-CCPs that qualify as non-systemically important, while Tier 2 are TC-CCPs that qualify as systemically important. Please see further details under "ESMA [Third-Country CCPs](#)"

<sup>8</sup> Draghi Report 'The future of European Competitiveness Part B | In-depth analysis and recommendations,' September 2024.

<sup>9</sup> Marcus Law, Technology Magazine 'AWS Remains USD 330bn Cloud Market Leader, Driven by AI Growth', 17 February 2025.

<sup>10</sup> See EBA Report on the EU dependence on non-EU banks and of EU banks' dependence on funding in foreign currency, 2022.

<sup>11</sup> Based on EBA reporting and limited to the exposures to the top 20 counterparties, Q4 2024.



exposure. Furthermore, the limited exposure to US Tier 1 CCPs is primarily comprised of futures contracts and is largely concentrated among Danish and German insurers.

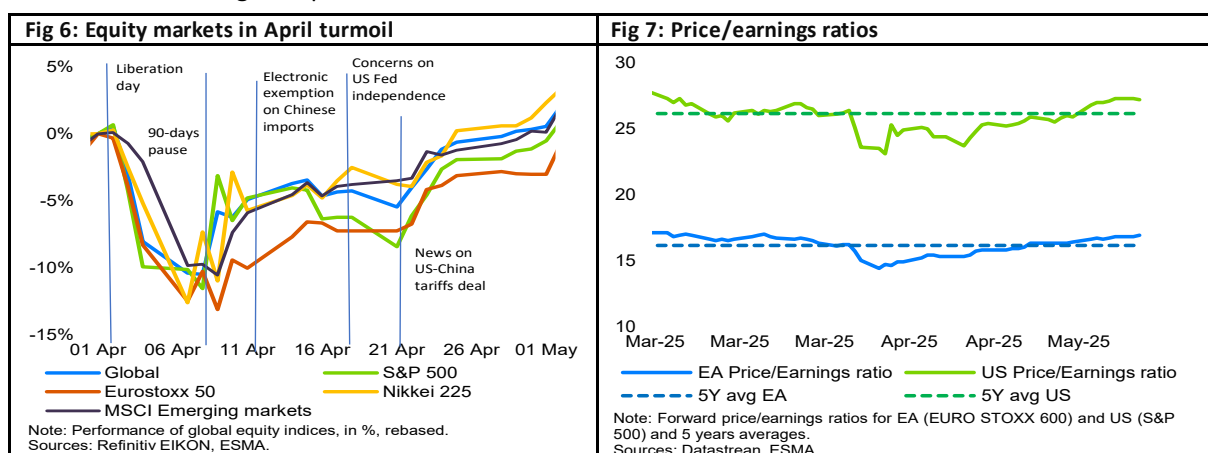
**Credit rating agencies with headquarters in the US rate the bulk of EU debt instruments**, with 73% of instruments rated by a CRA headquartered in the US, while 24% are rated by a CRA with headquarters in both the EU and the US. For structured finance, the US dependence is greatest, with 96% rated by CRA with only a US headquarter. Metrics for corporates (79%) and sovereigns (61%) are lower but still high. On the other hand, over 90% of lead analysts for EU instruments are based in the EU.

## 2 CROSS SECTORAL DEEP DIVE ON IMPACTS OF GEOPOLITICAL RISK AND FRAGMENTATION

### 2.1 IMPACT OF US TARIFF CHANGES

**From late February, the US administration announced a series of US tariff measures on imports globally.** These were surprising for their scale, rapidity, and suddenness of changes (e.g. suspensions). This generated substantial uncertainty and major market movements. Some of the main tariff announcements were increased tariffs on steel and aluminium, a baseline 10% tariff on all imports, 25% tariffs on autos and parts (Mar 26), “reciprocal” tariffs on countries worldwide in proportion to their trade surplus with US (Apr 2) then suspended for 90-days for all countries but China (April 9). There was also tit-for-tat escalation of tariffs through April between the US and China, though with more positive signs of potential de-escalation later in the month. Towards the EU, it was announced to introduce 50% import tariffs from 1 June, but negotiations were extended until 9 July. One difficulty is market expectations of further, as yet unannounced, policy measures that could be made at any point by the US Administration, adding to the already high level of uncertainty that affects directly the sentiment and decisions in the financial markets.

**Global equity markets declined following the US announcement of tariffs, with subsequent volatility driven by the rapidly changing news on trade policies.** Equity market volatility spiked sharply after the announcement before easing again. Market expectations for future US earnings growth, as proxied by the forward price/earnings (P/E) ratio, declined during the same period, falling below its five-year average and signalling growing concerns over a possible economic slowdown and recession risks. A similar, though more moderate, decline was observed in the euro-area forward P/E ratio. At the end of April and into May equity markets recovered on the signs of potential US-Chinese de-escalation.



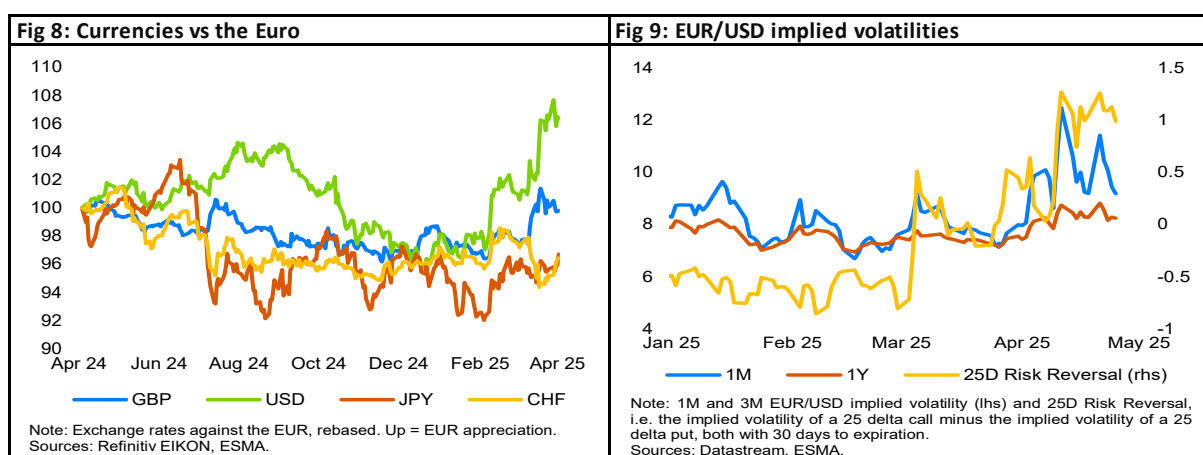
**In fixed income markets, US Treasury yields rose sharply following the announcement of tariffs, while German yields declined instead.** Fears of stagflation and concerns that the safe-haven status of US Treasury debt was weakening triggered a broad sell-off in US Treasuries, causing yields to spike across maturities. Additional pressure came from hedge funds unwinding highly leveraged basis and swap spread trades to meet margin calls.

Reflecting this volatility, the MOVE index—an indicator of implied volatility in the US Treasury market—spiked significantly before easing from mid-April onwards. In contrast, EU sovereign yields remained relatively stable over the same period and even declined, notably for German Bunds. This trend was also reflected in the narrowing spread between Bund yields and 10-year OIS rates, consistent with a flight-to-safety into Bunds. Finally, money market spreads widened considerably in the US, signalling a deterioration in funding liquidity, while remaining relatively stable in the EU.

**There was a jump in corporate spreads in both the US and the EU.** Risk aversion grew and credit conditions tightened (particularly for private credit and funding for riskier corporates) in the face of the uncertainty and growing expectations of a deterioration in the economic outlook from tariffs, with concerns growing of a potential US recession. EU corporate spreads jumped 30% in the week to 9 April, before falling back somewhat on more positive signals from the US administration. Similarly, spreads across European CDS categories substantially increased – especially in the high yield segment (+25% in the week to 9 April). In line with patterns on corporate bond spreads, CDS spreads have also fallen back. At sectoral level, insurance and energy companies saw the largest increase in yields in the week to 9 April by 6% and 4%, respectively.

**The global slowdown also spilled into commodities markets.** The Brent crude oil price hit a four-year low in April (-23% start of year to end of April) amid fears of a global economic slowdown and as market participants weighed the possibility of OPEC+ accelerating production increases. In line with such significant changes, volatilities in the commodity markets increased sharply. Conversely, gold prices rose steadily in this period (+25% start of year to end of April), reaching record highs as investors sought safe-haven assets amid the market turbulence. There were also further commodity developments with the Israeli-Iran conflict, leading to short-lived increases in the oil and natural gas (Dutch TTF) prices (which respectively rose by 9% and 13% from June 12 to 20.)

**In currency markets the USD depreciated significantly against alternative safe-haven currencies in April.** From 2 April to 2 May, the CHF, JPY, and EUR appreciated by 6.5%, 3%, and 4.1% respectively against the dollar. This decline in the USD marked a break from usual patterns: typically, rising US Treasury yields, and geopolitical tensions support the USD, given its role as the primary global safe-haven currency. In the EU, the reverse happened – as German yields fell, the Euro strengthened. Following US tariff announcements, implied volatility on the EUR/USD pair spiked sharply, with the spread between the 1-month and 1-year options widening, reflecting heightened short-term uncertainty. Similarly, the EUR/USD risk reversal<sup>12</sup> rose, indicating that investors were starting to assign a higher probability to an appreciation of the euro against the dollar—not only due to increased uncertainty in currency markets but also because of shifting interest rate expectations between the US and the euro area.



<sup>12</sup> In foreign exchange (FX) trading, risk reversal is the difference in implied volatility between similar call and put options, which can be used to assess how the market sees the balance of risks between a large appreciation and a large depreciation in the exchange rate.



**EU banks held nearly 30% of their exposure in foreign currencies, while they receive 21% of total funding in foreign currencies (without including foreign subsidiaries of EU banks).** Of foreign currencies, USD is the main contributor to funding of EU/EEA banks at 12% of total funding, based on consolidated reporting data<sup>13</sup>. The average liquidity coverage ratio (LCR) in USD as of December 2024 stood at 111% and increased compared to the level observed as of December 2023 (110%), when it reached a level above 100%. The average net stable funding ratio (NSFR) in USD declined below 100% for the first time since Q1 2021 and stood at 98% as of Q4 2024 (102% in Q4 2023). Potentially low liquidity levels in one or several foreign currencies may lead to vulnerabilities in periods of high volatility, as the possibility of banks to raise funding in other currencies or to cover the risk of FX on markets may become a challenge.

**For the insurance sector and the IORP sector, sensitivity to the currency exposure is significant due to the overall imbalance between investments and liabilities.** The effect of tariffs on the EUR/USD exchange rate is difficult to predict. Although the US dollar initially saw a material appreciation (Q4 2024) and there were expectations that the USD would maintain or strengthen its value (particularly due to reduced supply and increasing interest rate differentials), the opposite occurred. On aggregate USD is the most material foreign currency in insurers' investments, which would benefit from USD appreciation and would suffer from USD depreciation. Insurers' use of derivatives can partially hedge from exchange rate fluctuations.

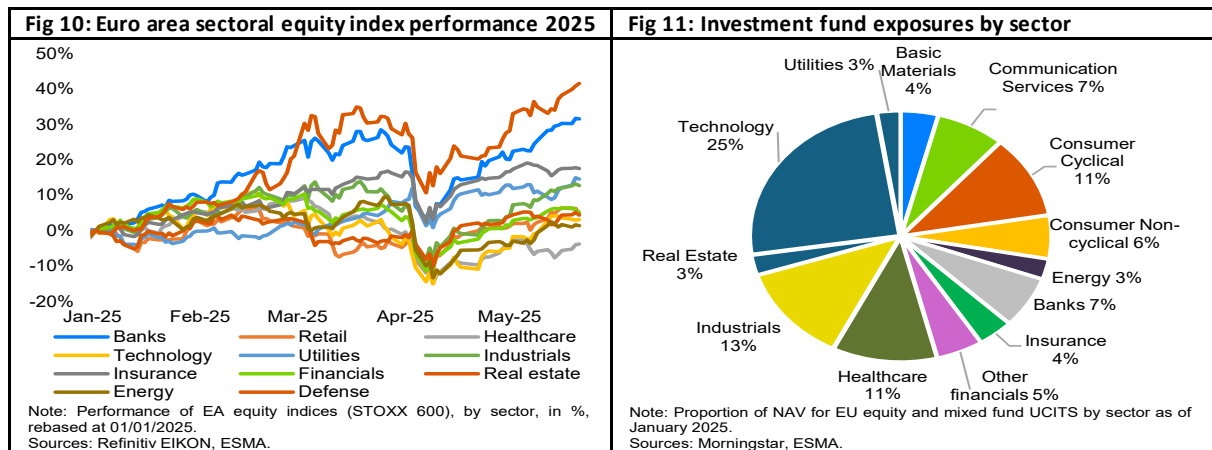
**In Europe, US tariffs are expected to primarily affect those sectors exhibiting a substantial direct or indirect link to export flow (in terms of volume and value) to the US.** US tariffs may also affect sectors indirectly impacted by a potential trade war. The tariff policies of the US administration could impact growth substantially. ECB analysis indicates that implementation of a 25% tariff by the US on imports from Europe would reduce euro area growth by approximately 0.3 percentage points. If Europe were to respond by increasing tariffs on US imports, this reduction could rise to about 0.5 percentage points, primarily affecting the first year of tariff implementation but also impairing growth in subsequent years.<sup>14</sup> In late July, the EU and the US reached a preliminary agreement on tariffs at 15%, with further clarity in late August that this level would for instance also apply to the automobile sector.

**In terms of sectoral impacts, all sectors were strongly impacted on the announcement of reciprocal tariffs on April 2, until their 90-day suspension on April 9.** There were falls in euro area sectoral equity indices over the period from April 1 to 9, ranging from -20% for energy to -7% for utilities and retail. Significant impacts were seen across other sectors, with limited variation: banks (-17%), insurers (-11%), defense (-14%), financials (-14%), industrials (-14%), healthcare (-15%) and technology (-13%). Also, by the end of the April, all sectors except energy had recovered most if not all of the initial losses (Fig 10).

**European investment funds are significantly invested in US securities.** Euro-area UCITS funds, for example, had EUR 1.3tn NAV in US bonds, 22% of the total, and EUR 3.2tn NAV in US equities, 45% of the total NAV as of Q3 24. Similarly, alternative investment funds exposures to North America were EUR 1.4tn, 14% of net asset value. While for EU exchange trade funds (ETFs) 36% of the assets under management were primarily invested in the US. In addition, US parent companies managed nearly two thirds, 62%, of EU ETF assets under management. In terms of sectoral exposures for EU equity and mixed funds, as of January 2025, there were particularly significant technological, industrial, consumer cyclical and healthcare exposures (Figure 11). Together these accounted for 60% of the net asset value of portfolios of these types of funds.

<sup>13</sup> See EBA reports on [Call for Advice on non-EU entities and funding of EU banks](#), and on [EU banks' funding structure and their dependence on foreign currency](#), April 2025.

<sup>14</sup> ECB's Chairwoman speech Christine Lagarde (citation pending)



Some banks are expected to be indirectly affected by tariffs through high exposures to trade-sensitive sectors that are vulnerable to tariffs and which could face deteriorating asset quality if corporate fundamentals were to deteriorate. Tariffs are expected to primarily adversely affect sectors that exhibit a substantial export flow in terms of volume and value to primarily the US. Data from the US International Trade Data Commission shows that in 2024 EU countries exported over USD 650bn worth of products in total. Pharmaceutical products, machineries, vehicles, electrical products and organic chemicals accounted for more than 55% of these exports. This implies that the manufacturing sector will probably be among the most affected, as the five<sup>15</sup> most important categories of EU/EEA exports are classified under manufacturing goods.

One example of indirect effect would be EU/EEA banks exposure to manufacturing, with nearly EUR 1tn in loans towards the manufacturing sector in Q4 2024. According to ESG Pillar 3 data, around 35% of manufacturing loans are to sectors that resemble the most important export categories to the US. Although the EU banking sector is materially exposed to companies related the automotive industry, these do not exceed 8% of total manufacturing loans. Spanish, German and Italian banks have provided the biggest share of these loans. EU/EEA banks have also material exposure towards companies related to steel and aluminium, on which the imposition of additional US tariffs will presumably have an adverse effect, also affecting other important sections of manufacturing, such as basic metals and fabrication of metal products. US tariffs on EU exports of steel and aluminium could moreover impact mining and quarrying. Exporting companies of agricultural products may also be confronted with a challenging environment stemming from tariffs and a potential trade war. A shift in the supply chain dynamics as a result of additional tariffs could also have a broader effect, not only on corporates but on households as well.

The impacts of a potentially escalating trade war on individual banks would be determined by the degree to which their clients are affected by the increased tariffs. Impacts could manifest themselves via provisions EU/EEA banks made against exposures towards struggling corporates, as clients involved in trade-sensitive sectors may face increased default risks on loans. Income streams such as fee generation and lending opportunities may also be affected by reduced cross-border activity or disruptions in global trade.

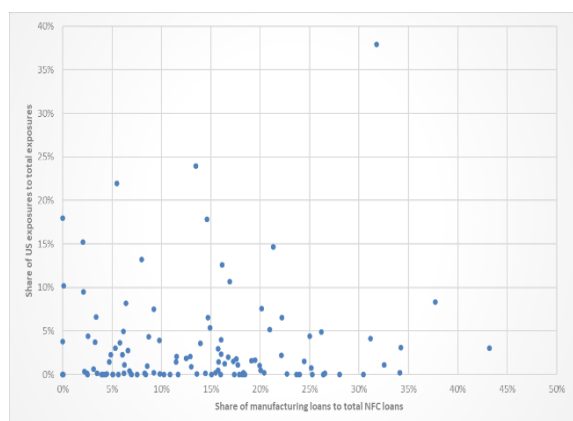
Sector-level financing needs and lending dynamics might change significantly amid geopolitical tensions and tariffs. This would not least be due to possible readjustments to supply chain dynamics as a result of new or higher trade tariffs or the need for increased defence spending in Europe. Banks may also face increasing

<sup>15</sup> The 5 most important exports would include NACE code Sector C "Manufacturing": Division 21 "Manufacture of pharmaceutical products" for "Pharmaceutical Products", Division 28 "Manufacture of machinery and equipment" for "Nuclear Reactor, Boilers, Machinery and Mechanical Appliances, parts thereof", Division 29 "Manufacture of motor vehicles" for "Vehicles, other than railway or tramway or rolling stock and parts and accessories thereof", Division 27 "Manufacture of electrical equipment" for "Electrical machinery and equipment and parts thereof; sound recorders and reproducers, television recorders and reproducers, parts and thereof", Division 26 "Manufacture of optical and precision instruments" for "Optical, photographic, cinematographic, measuring, checking, precision, medical or surgical instruments and apparatus, parts and accessories thereof" and Division 20 "Manufacture of chemicals" for "Organic chemicals"

provisioning needs against credit losses if geopolitical tensions impact macroeconomic conditions, with adverse implications for asset quality. Escalating geopolitical tensions, however, would potentially have a much broader impact through slower economic growth, both through weaker credit demand and from investment delays due to uncertainty.

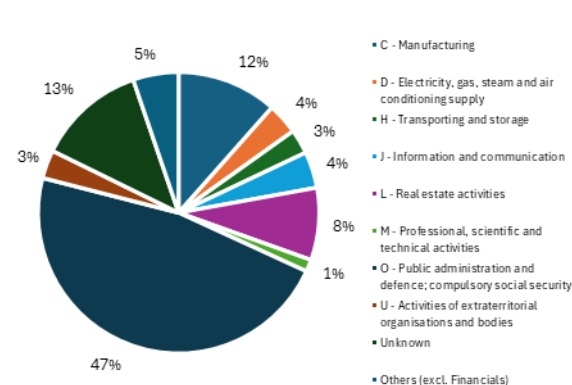
**The resilience of the EU banking sector in scenario of high economic uncertainty and geopolitical risk is being assessed in the current EBA 2025 EU wide stress test.** The adverse scenario is based on a narrative of hypothetical worsening of geopolitical tensions, with large, negative, and persistent trade and confidence shocks having strong adverse effects on private consumption and investments, both domestically and globally. The final results are planned to be published in August 2025.

**Fig 12: Share of US exposures to total exposures vis-vis share of manufacturing loans to total NFC loans by bank (%), December 2024<sup>16</sup>**



Source: EBA supervisory reporting data

**Fig 13: Insurers investment by NACE sectors (excl. financials)**



Source: EIOPA Solvency II reporting

**For the insurance and IORP sectors, tariffs are expected to have mostly indirect effects also through exposure to sensitive sectors as well as other factors** such as market volatility, currency risk, claims inflation. The sectors may see also increased business in areas dealing with trade risks but may face difficulties in doing business and growing organically.

**For instance, insurer investment sectors affected by tariffs, via holdings of corporate bonds or equity, might face losses.** Overall, aside from investments in other financial assets (63% of total investments), EU insurers are mainly exposed to the following sectorial developments: public administration and defence (17% of total investments), manufacturing (4% of total investments). However, this also depends on the country of the asset's issuer. For any given sector, different countries can have different levels of exports to the US, hence different potential impacts.

**Moreover, both insurers and IORPs are exposed to market dynamics outside the EEA.** Around 30% of total investments are issued outside the EEA, of which almost 12.5% is to the US (35.4% in bonds, 57.0% in equity, 7.6% in others). For IORPs the exposure is higher: 45.5% outside EEA of which 25% in US (24% in bonds, 58% in equities, 19% in others)<sup>17</sup>. For IORPs, supervisors do not clearly expect a reduction of assets exposures towards USD-denominated assets and assets issued by US-domiciled entities amid increasing division and divergences in

<sup>16</sup> Exposures to US include also sovereign exposures which in several cases is a major driver of banks' exposures to this country.

<sup>17</sup> IORP statistics 2023, annual reporting, look through included. The analysis is performed considering the issuer country of the assets. Funds are excluded, because the country of issuance of a fund does not inform of the country of issuance of the assets held within the fund. Note: The analysis on IORPs assets is performed considering together the information on individual submissions (available for AT, BG, DE, DK, FI, FR, HR, LI, LU, LV, NL, NO, PL, PT, SE, SI, SK) with aggregate data (BE, ES, IT, MT). Look-through information is limited on individual submission only. Nevertheless, including aggregate data allows to capture their direct exposure and total asset size.

**Interconnectedness across European insurers within and outside the EEA could propagate the impact of tariffs.** German and Irish insurers are particularly exposed to the US market, with EUR 19.2bn and EUR 8.8bn in premiums. Together, these account for more than 80% of the EEA's direct exposure to the US, other EEA countries have significant premiums linked to risks in Germany, totalling EUR 26.7bn, which shows region's complex market relationships.

Source: EIOPA Annual Reporting Solo Solvency II Q4 2024

Page | 12

scenario, hence a reduction of capital in the industry as a result of the Solvency II Review will have an impact on this resilience.

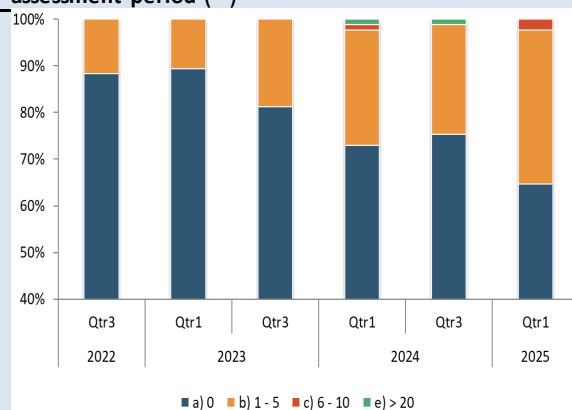
**On the liquidity side, position of insurers and IORPs can be challenged by the market movements.** As observed in H1 2025, sharp movements in interest rates and FX rates trigger margin calls on derivative positions. While the insurance sector proved to be resilient to the increase in interest rates, as considered also in the scenario of the 2024 Insurance Stress Test exercise, due to the ample availability of liquid assets, the monitoring of liquidity risk remains relevant for insurers and supervisors. Similarly, for the IORPs sector, the ongoing 2025 stress test exercise is testing their liquidity resilience in two scenarios which might be triggered by a geopolitical disruption, namely a sharp increase in interest rates due to an abrupt escalation of geopolitical tensions and also a swift decline in interest rates, as market participants internalise an unexpected prolongation of geopolitical tensions, triggering a loss of confidence in financial markets.

#### BOX 2 – Heightened cyber risks and risks related to crypto assets in the current geopolitical context.

**The current geopolitical landscape and ongoing global trade disputes pose significant risks to financial market stability, requiring vigilant management of risks related to digitalisation, including to mitigate potential disruptions.** While geopolitical risks remain high, it may further increase digital risk via, e.g., state sponsored malicious cyber activities and “hacktivism”.<sup>18</sup> The increasing reliance on digital systems and technology also emphasises the need for robust information and communication technology (ICT) frameworks and risk management strategies to be implemented and regularly updated to protect against these emerging threats.

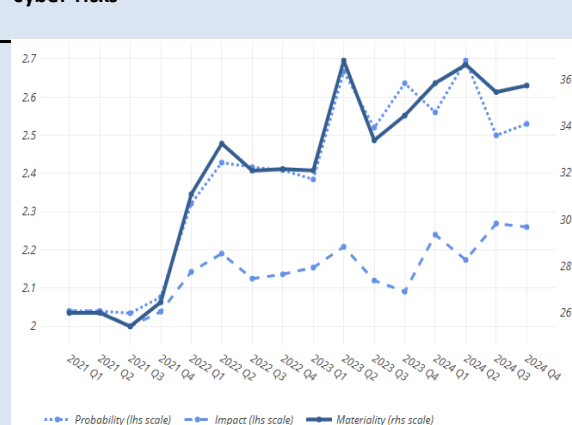
**A recent report by the EU Agency for Cybersecurity’s (ENISA) also highlights a substantial increase in the variety of cyberattacks<sup>19</sup>.** The financial sector remains a prime target due to the vast amounts of sensitive data and transactions it handles. Cyberattacks on financial institutions and critical market infrastructure can disrupt critical services, erode confidence, and cause spillovers to other sectors. ENISA’s Threat Landscape for the financial sector identifies DDoS and ransomware as the most reported forms of attacks in the EU, and the sector saw peaks in DDoS activity linked to geopolitical events. Geopolitical tensions can not only amplify operational risk, but can also indirectly affect the financial sector, by increased risks of malicious behaviour, such as, e.g., acts of sabotage potentially affecting the financial infrastructure.

**Fig 15: Number of successful cyber-attacks resulting in ‘major ICT-related incidents’ in the last semi-annual assessment period<sup>(20)</sup>**



Source: EBA Risk Assessment Questionnaire Spring 2025

**Fig 16: Supervisory assessment of digitalisation and cyber risks**



Source: EIOPA Risk Dashboard April 2025. Note: Scores compiled based on the assessment of probability and impact (lhs: scale from 1 to 4) of digitalisation & cyber risks from National Competent Authorities. The country average for each answer is then normalised (rhs: scale 0-100).

<sup>18</sup> Hacktivists include, e.g., threat actors hacking or breaking into computer and data systems for politically or socially motivated purposes.

<sup>19</sup> European Union Agency for Cybersecurity (ENISA), 2025. [Threat Landscape: Finance sector](#), February.

<sup>20</sup> This relates to an ICT-related incident with a potentially high adverse impact on the network and information systems that support critical functions of the financial entity (Article 3(7) DORA).



**Cyber risks were the third most cited risk in ESMA's June 2024 risk survey of NCAs**, with risks to infrastructures, particularly trading venues and central security depositories, being highlighted as a concern. Moreover, in a recently published analysis<sup>21</sup> ESMA has explored conceptual frameworks to examine how individual incidents can become systemic, by focusing on exposure to cyber threats, the propagation of the shock through the system, and their impacts. A simulation analysis was conducted on the EU repo market, examining scenarios in which a hypothetical cyber incident disrupts settlement operations at key market players. Results indicate that operational disruptions at a few critical institutions can trigger temporary yet severe liquidity shortages at both system and counterparty level, with widespread network effects.

**Operational risk, in particular cyber risk, has increased further in the banking sector and is not least amplified by high geopolitical risk.** An EBA survey<sup>22</sup> indicates an increase in the share of banks having faced at least one successful attack which resulted in an actual major ICT-related incident, amid a growing volume and frequency of cyber-attacks.

**The insurance sector faces both cyber underwriting risk and resilience challenges.** In the current geopolitical context, cyber threats are a significant concern as insurers are not only exposed to operational risks but also face the growing challenge of underwriting cyber risks, which adds complexity to their risk management strategies. The latter concerns the undertakings' ability to manage losses from their cyber insurance portfolio, while the former is about the financial impact of an adverse cyber-event on their own operations. The materiality of these risks for the insurance sector, as assessed by supervisors, slightly increased in Q4 2024.

**Network interruption and cyber extortion are the most frequent type of cyber-attacks with the type of cyber risks coverages underwritten by insurers.** This can include network interruptions such as DDoS attacks and malware that causes systems to fail. This is followed by the cyber extortion risk type, which can also include DDoS attacks. Artificial intelligence (AI) is also changing the technological landscape and the nature of cyber risks. AI is increasingly being used in cyberattacks, for example, generating scam emails and malicious scripts. Across financial sectors, AI is being used for process automation to improve efficiency, which while beneficial also amplifies third-party dependency and cyber risks. More positively, AI might be an important means to address cyber threats.

**A major development around cyber resilience is the Digital Operational Resilience Act (DORA)**, applicable since January 2025, which aims at mitigating risks from cyber threats, service failures, and technological vulnerabilities, and includes oversight of critical third-party ICT service providers.

**In crypto markets, there are risks from regulatory divergence.** President Trump's election victory initially triggered a surge in crypto-asset prices, as his pro-crypto stance fuelled market optimism. The rally pushed the crypto-asset market capitalisation to a record high of EUR 3.3tn at the end of December 2024, a 27% increase compared to the previous high of 2021 (EUR 2.6tn). This optimism was reinforced by the new U.S. administration's pro-crypto asset actions, marked by executive orders<sup>23</sup> promoting crypto-asset growth and the SEC's decision to drop or pause several lawsuits against crypto firms. There are two acts currently in the US legislative process, GENIUS Act and Stable Act, that are expected to result in a comprehensive licensing and oversight regime for digital assets and stablecoin issuers<sup>24</sup>. However, valuation levels receded in H1 2025 amid macroeconomic uncertainties and investor caution, crypto-assets markets receded to EUR 2.7tn in April 2025, a 18 % decrease in four months.

**External contagion risks from crypto assets remain limited so far but should be monitored due to growing interlinkages between crypto markets and the traditional financial sector as crypto markets continue to expand.** Close relationships and new business lines are developing between traditional market players and digital asset markets. Banks have advanced regarding their engagement with crypto assets, at the same time increasing the potential underlying risks.

<sup>21</sup> O. Panzarino 2025 "Operational and cyber risks in EU financial markets: measurement and stress simulation", 16 July 2025.

<sup>22</sup> EBA Risk Assessment Questionnaire (RAQ), Spring 2025

<sup>23</sup> The White House, 2025. Executive orders on [Strengthening American Leadership in Digital Financial Technology](#) and [Establishment of the Strategic Bitcoin Reserve and United States Digital Asset Stockpile](#) – The White House, 23 January 2025 and 9 March 2025.

<sup>24</sup> <https://www.arnoldporter.com/en/perspectives/advisories/2025/06/incoming-stablecoin-legislation-stable-and-genius-acts>

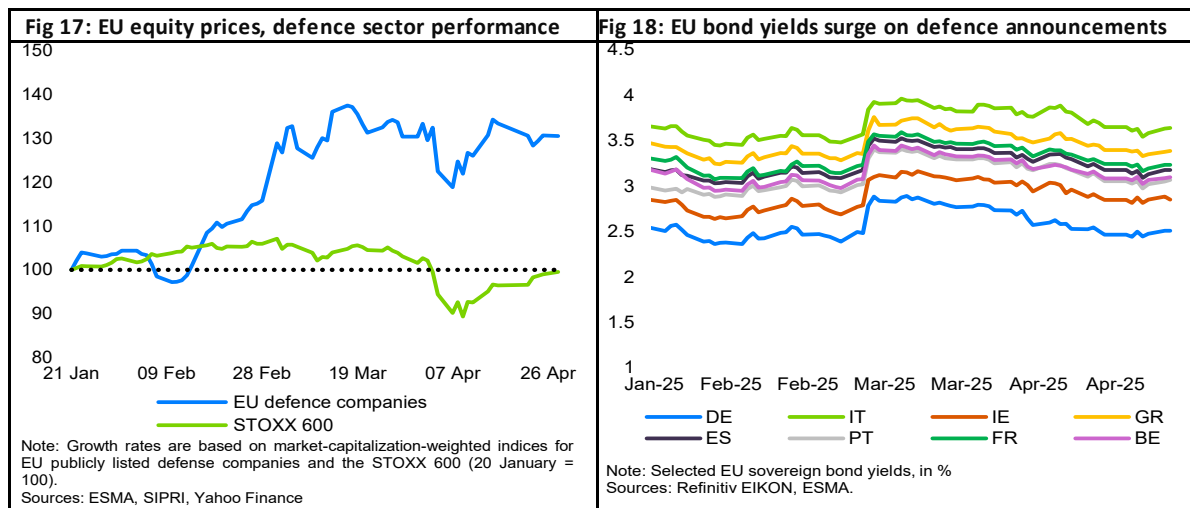


## 2.2 IMPACT OF INCREASED SPENDING INCLUDING DEFENCE

**The move to increase defence spending in Europe is driving significant market movements.** There have been major policy shifts. In March the EU introduced the “Readiness 2030” initiative which aims to direct EUR 800bn of spending to defence, including raising EUR 150mn in EU bonds to be lent to Member States. Germany in particular also took major steps, voting to modify its ‘debt brake’ in the constitution to fund investments in infrastructures and defence, and approving a package to increase spending on defence and infrastructure by EUR 1tn.

**EU defence equities performance.** Since the new US administration took over on January 20 until the end of April, the largest EU defence companies grew by 30% as compared to a fall of 1% for the overall EU stock market. Growth accelerated after an emergency meeting on Europe’s security took place in Paris in February and remained relatively stable in March and for most of April. Growth rates across companies vary significantly, ranging from -5% to +149%, with German companies leading the gains.

**On sovereign bond markets,** yields increased especially in Germany amid plans for a very large increase in German borrowing to fund investments in infrastructures and defence. On March 5, Bund yields rose by 30bps the largest daily increase in decades, with similar increases seen in other EU bond yields. Over the subsequent months, and particularly with the falls in European yields in April as US yields rose, yield fell back to pre-March levels.



**Signs of growth in fund exposures to defence companies:** As of April 2025, there were five ETFs with more than 15% of their AuM invested in EU defence companies, with one fund (that was launched in March 2025) investing more than 50%. Since early 2025, these funds have grown significantly, driven by robust defence stock performance and rising inflows. To illustrate, of the five ETFs, the four funds that were launched before March 2025 have received EUR 2.9bn in inflows since February 2025.

**For insurers, the sharp changes in market interest rates, as seen in the increases in bond yields with the increases in defence spending, can have material consequences due to a decline in the value of both liabilities and fixed-income investments and the impact on derivative valuation which might trigger margin calls.** In fact, while the ultimate impact on capitalization levels depends on the duration gap between assets and liabilities, life insurers, which typically have negative duration gaps (i.e. longer liabilities duration), tend to see improved capitalization when interest rates rise and deteriorated capitalization when rates fall. For this reason, several insurers use derivatives to match liabilities with long durations and to be protected against interest rate declines, but these can still face a liquidity challenge. By the end of 2024, 64 insurers had a strategy to receive fixed rates,

aiming to match liabilities and protect against interest rate declines<sup>25</sup>. However, this exposes them to potential losses and margin payments if rates rise.

**A sensitivity analysis<sup>26</sup> estimates that a 30-basis-point market interest rate increase would result in EUR 9bn in margin payments for insurers with mark-to-market losses, while those with mark-to-market profits would receive only EUR 1.9bn.** For the top 20 insurers, this could account for 1-4% of their investments. While some may face liquidity shortfalls, insurers can use highly liquid government bonds and repo facilities to meet margin payments, with some regulators noting that these facilities are in place as an effective liquidity management tool.

**Increased spending requires fiscal space, otherwise it may necessitate budget cuts or markets could reprice sovereign risk.** Ways of defence spending will also be important, as, e.g., spending on imports or rushing to increase military capacity, e.g., without sustained R&D spending, can only have a short-lived positive effect for the economy. For insurers the higher supply of (safe) bonds suggests interest rates can move higher (all else being equal), making existing insurance contracts unattractive to policyholders with respect to alternatives saving options, leading them to potentially terminate their contracts (posing lapse risk) unless contracts are promptly adjusted to market rates. Finally, more broadly, higher interest rates also increase borrowing costs and widen spreads, posing challenges for heavily indebted countries or firms. Some member States may also face challenges in accommodating higher defense budgets without encountering fiscal strain. The EU's average debt-to-GDP ratio reached 82% in late 2024, showing a further year-over-year increase of 0.1%, amid significant country-by-country differences.

**While defence funding is expected to mostly come from member States contributions as well as from "Readiness 2030", private finance is also expected to have a role in these developments.** EU/EEA banks are expected to sustain defence-related firms through direct corporate lending, as well as infrastructure tied to defence readiness and R&D centres for military innovation through project-based lending. Until the recent defence policy shift, EU/EEA banks reported a decline in outstanding loans towards public administration, defence and compulsory social security by -12.3% YoY in 2024.

### 3 CONCLUSIONS

The EU financial system is facing significant risks from geopolitical uncertainties and the potential for rapid changes in global trade policies. The US tariff measures have generated substantial uncertainty and major market movements. While global equity markets declined and volatility spiked for a time, the financial sector continued to demonstrate resilience. The EU banking sector is expected to be indirectly affected by tariffs, with potential impacts on the corporate exposures of trade-sensitive sectors, income streams, and credit demand. The wider financial sector is also expected to be affected, with potential increases in operational risks, changes in pricing, and growth in trade-related insurance areas.

The EU's dependence on third party service providers, CCPs and credit rating agencies based outside the EU is not negligible and highlights a need for greater EU autonomy. At the same time, there is also an increasing reliance on digital systems and technology that increases the need for robust ICT infrastructures and risk management strategies to mitigate potential disruptions.

The increase in defence spending in Europe also drove significant market movements, with EU defence equities performance growing by 30% since the beginning of 2025. Impacts on sovereign bonds were also significant, with yields increasing in response to the announcement of increased borrowing to fund investments in infrastructures and defence, before falling back down in April as US tariff policies primarily affected markets.

---

<sup>25</sup> On the contrary, 41 insurers had taken on an opposite strategy to pay fixed rates, hedging their fixed-income portfolios, which would cause margin receipts if interest rates increased.

<sup>26</sup> [EIOPA, Financial Stability Report, June 2025](#)

Insurers were also affected, with sharp changes in interest rates having material consequences due to the decline in the values of both liabilities and fixed-income investments. While the increase in defence spending can be a positive, it also requires fiscal space and careful planning to avoid negative consequences, such as budget cuts, repricing of sovereign risk, or possible increases in interest rates.

Given global trade shifts and the market reactions, capital buffers remain essential for the robustness of the financial system, as they provide the capacity to absorb shocks and maintain confidence in times of heightened uncertainty. Strong buffers also help to mitigate pro-cyclical behaviour, support the continued provision of financing to the real economy, and create room for an orderly adjustment to structural challenges such as geopolitical risks.